



NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Consolidated Financial Statements
and Supplementary Information

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Consolidated Financial Statements and Supplementary Information

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KPMG LLP
50 Kennedy Plaza
Providence, RI 02903-2321

Independent Auditors' Report

The Board of Trustees
Newport Health Care Corporation:

We have audited the accompanying consolidated statements of financial position of Newport Health Care Corporation and Affiliates (the Corporation) as of September 30, 2006 and 2005, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Newport Health Care Corporation and Affiliates as of September 30, 2006 and 2005, and the results of their operations and changes in net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

January 29, 2007

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Consolidated Statements of Financial Position

September 30, 2006 and 2005

Assets	2006	2005
Current assets:		
Cash and cash equivalents	\$ 9,050,116	\$ 9,133,415
Patient accounts receivable	13,094,021	12,200,507
Less allowance for doubtful accounts	<u>(2,840,933)</u>	<u>(2,481,258)</u>
Net patient accounts receivable	10,253,088	9,719,249
Other receivables	371,508	564,683
Current portion of contributions receivable	<u>448,855</u>	<u>460,585</u>
Total receivables	11,073,451	10,744,517
Assets limited as to use	5,604,860	5,377,462
Inventories	385,903	385,595
Prepaid expenses and other current assets	<u>760,926</u>	<u>879,418</u>
Total current assets	<u>26,875,256</u>	<u>26,520,407</u>
Assets limited as to use	214,242,097	195,013,686
Less amount required to meet current obligations	<u>(5,604,860)</u>	<u>(5,377,462)</u>
Noncurrent assets limited as to use	<u>208,637,237</u>	<u>189,636,224</u>
Property and equipment, net	75,010,510	77,271,545
Other assets:		
Contributions receivable, net	629,064	455,743
Deferred charges and financing costs, net	313,684	329,399
Other noncurrent assets	<u>5,023,480</u>	<u>6,012,635</u>
Total other assets	<u>5,966,228</u>	<u>6,797,777</u>
Total assets	\$ <u>316,489,231</u>	\$ <u>300,225,953</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 1,966,878	\$ 1,865,289
Intercompany financing	604,574	45,059
Accrued employee benefits and compensation	4,278,843	3,974,998
Other accrued expenses	547,213	783,482
Current portion of long-term debt	1,630,000	1,605,000
Current portion of estimated third-party payor settlements	1,229,811	1,896,630
Estimated health care benefit self-insurance costs	<u>400,478</u>	<u>573,598</u>
Total current liabilities	10,657,797	10,744,056
Long term debt, net of current portion	32,605,000	34,235,000
Estimated third-party payor settlements, net of current portion	4,888,929	5,188,076
Other liabilities	<u>544,600</u>	<u>517,300</u>
Total liabilities	<u>48,696,326</u>	<u>50,684,432</u>
Net assets:		
Unrestricted	213,135,402	197,626,911
Temporarily restricted	27,460,282	25,767,721
Permanently restricted	<u>27,197,221</u>	<u>26,146,889</u>
Total net assets	<u>267,792,905</u>	<u>249,541,521</u>
Total liabilities and net assets	\$ <u>316,489,231</u>	\$ <u>300,225,953</u>

See accompanying notes to consolidated financial statements.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2006 and 2005

	2006	2005
Unrestricted revenues and other support:		
Net patient service revenue	\$ 99,779,397	\$ 97,777,908
Other revenue	1,619,008	1,994,782
Endowment earnings contributed toward community benefit	994,850	997,257
Net assets released from restrictions used for operations	1,169,267	786,501
Total unrestricted revenues and other support	103,562,522	101,556,448
Operating expenses:		
Compensation and benefits	56,058,492	53,808,553
Supplies and other expenses	16,713,554	15,846,789
Purchased services	14,735,025	14,594,878
Provision for bad debts	5,782,439	6,383,821
Depreciation and amortization	6,211,142	6,176,083
Interest	1,676,103	1,603,018
License fees	2,975,999	2,390,761
Total operating expenses	104,152,754	100,803,903
(Loss) income from operations	(590,232)	752,545
Nonoperating gains:		
Unrestricted income from board-designated investments	2,468,632	2,337,250
Net realized gains on sales of board-designated investments	10,780,962	8,938,013
Unrestricted gifts and bequests	—	188,668
Total nonoperating gains, net	13,249,594	11,463,931
Excess of revenues over expenses	12,659,362	12,216,476
Other changes in unrestricted net assets:		
Net unrealized gains on investments	2,831,553	9,098,730
Net assets released from restrictions used for purchase of property and equipment	21,154	18,147
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	(30,570)	—
Contributions of property and equipment	26,992	—
Increase in unrestricted net assets	15,508,491	21,333,353
Temporarily restricted net assets:		
Gifts, grants and bequests	252,856	112,157
Income from restricted investments	671,352	620,212
Net assets released from restrictions	(1,190,421)	(804,648)
Net realized and unrealized gains on investments	2,432,572	3,216,441
Transfer to permanently restricted net assets	(473,798)	—
Increase in temporarily restricted net assets	1,692,561	3,144,162
Permanently restricted net assets:		
Net realized gains on investments held in perpetual trust by others	62,547	103,653
Realized gains retained to maintain purchasing power	513,987	1,115,728
Transfer from temporarily restricted net assets	473,798	—
Increase in permanently restricted net assets	1,050,332	1,219,381
Increase in net assets	18,251,384	25,696,896
Net assets, beginning of year	249,541,521	223,844,625
Net assets, end of year	\$ 267,792,905	\$ 249,541,521

See accompanying notes to consolidated financial statements.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Increase in net assets	\$ 18,251,384	\$ 25,696,896
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	30,570	---
Net realized and unrealized gains on investments	(16,621,621)	(22,472,565)
Temporarily restricted gifts, grants and bequests	(252,856)	(112,157)
Depreciation and amortization	6,211,142	6,176,083
Provision for estimated health care benefit self-insurance costs	6,393,504	4,684,809
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(6,566,624)	(4,111,211)
(Increase) decrease in patient accounts receivable, net	(533,839)	1,288,961
(Increase) decrease in contributions receivable, net	(161,591)	273,672
Increase (decrease) in accounts payable	101,589	(652,617)
Increase (decrease) in accrued employee benefits and compensation	303,845	(28,488)
(Decrease) increase in other accrued expenses	(189,739)	191,105
Decrease in estimated third-party payor settlements	(965,966)	(602,667)
Decrease in all other current and noncurrent assets and liabilities, net	1,039,031	880,903
Net cash provided by operating activities	<u>7,038,829</u>	<u>11,212,724</u>
Cash flows from investing activities:		
Purchase of property and equipment	(3,950,107)	(4,035,228)
Net increases in assets limited as to use	(2,379,392)	(1,837,977)
Net cash used in investing activities	<u>(6,329,499)</u>	<u>(5,873,205)</u>
Cash flows from financing activities:		
Financing from (payments to) affiliates	559,515	(916,568)
Payments on long-term debt	(1,605,000)	(1,580,000)
Temporarily restricted gifts, grants, and bequests	252,856	112,157
Net cash used in financing activities	<u>(792,629)</u>	<u>(2,384,411)</u>
Net (decrease) increase in cash and cash equivalents	(83,299)	2,955,108
Cash and cash equivalents, beginning of year	<u>9,133,415</u>	<u>6,178,307</u>
Cash and cash equivalents, end of year	\$ <u><u>9,050,116</u></u>	\$ <u><u>9,133,415</u></u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ <u><u>1,650,307</u></u>	\$ <u><u>1,599,470</u></u>

See accompanying notes to consolidated financial statements.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(1) Description of Organization and Summary of Significant Accounting Policies

(a) Organization and Basis of Presentation

Newport Health Care Corporation and Affiliates (the Corporation) includes Newport Health Care Corporation (NHCC), Newport Hospital (the Hospital), Newport Hospital Foundation, Inc. (the Foundation), NHCC Medical Associates, Inc. (Medical Associates), and Newport Health Property Management, Inc. (Property Management).

NHCC is the sole corporate member of the Hospital, the Foundation and Medical Associates. NHCC is also the sole shareholder of Property Management. The Hospital is a 129-bed nonprofit acute care hospital which provides inpatient, outpatient and emergency care services for residents of southern Rhode Island. The Foundation manages fundraising activities and certain investments of NHCC affiliates. Medical Associates was formed to employ physicians and other health care practitioners in developing integrated and comprehensive health care services. Property Management directs the operations of various health care properties.

Effective June 2, 2006, the Hospital removed 19 sub-acute beds from service, temporarily reducing the Hospital's licensed beds from 148 to 129 based on a review of services and community need. This was completed in accordance with Rhode Island Department of Health regulations.

Effective January 15, 1997, the Federal Trade Commission and the Health Services Council of the Rhode Island Department of Health approved NHCC's affiliation with Lifespan Corporation (Lifespan), a Rhode Island nonprofit corporation. The Corporation continues to maintain its own identity and Board of Trustees, its own campus and its own name. Lifespan has the responsibility for strategic planning and initiatives as well as capital and operating budgets. The transaction was accounted for as a pooling of interests at the Lifespan level.

The consolidated financial statements include the accounts of NHCC and its affiliates after elimination of significant intercompany accounts and transactions.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use by board-designation or other arrangements under trust agreements.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated statements of financial position. Investments in collective investment funds are measured based on the fair value of the underlying investments. Investments of less than 5% in venture capital, oil & gas, and real estate limited partnerships are recorded at historical cost. Management believes the fair value of the investments in these limited partnerships exceeds its carrying amount. Investments of 5% or more in limited partnerships, limited liability corporations or similar investments are accounted for at fair value, with changes in fair value recorded as realized gains or losses in each net asset class using the equity method. Investments in derivative financial instruments are not material.

The aggregate amount of the fair value of permanently restricted investments complies with the inflation protection requirements of the General Laws of the State of Rhode Island.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments other than those accounted for using the equity method are excluded from the excess of revenues over expenses.

Realized gains (losses) on sales of investments are determined by the average cost method. Realized gains (losses) on unrestricted investments are recorded as nonoperating gains (losses); realized gains (losses) on restricted investments are recorded as an addition to (deduction from) the appropriate restricted net assets. A decline in the market value of an investment security below its cost that is designated to be other than temporary is recognized through an impairment charge classified as a realized loss and a new cost basis is established.

Participation units in pooled investment funds held within unrestricted and permanently restricted net assets are determined monthly based on the market value of the underlying investments at the calculation date. Income earned on pooled investments is allocated to participating funds based on their respective unit shares of the pool.

Investment income from trustee-held funds under bond indenture agreements is recorded as other revenue. Lifespan maintains a spending policy for certain board-designated funds of its patient care affiliates which provides that investment income from such funds is recorded within unrestricted revenues as endowment earnings contributed toward community benefit.

Income from permanently restricted investments is recorded as nonoperating gains when unrestricted by donor and as an addition to the net assets of the appropriate restricted fund when restricted by donor.

(e) Assets Limited as to Use

Assets limited as to use primarily include assets set aside by the Corporation's Board for future capital improvements, over which the Board retains control and may at its discretion subsequently

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

use for other purposes, and assets whose use by the Corporation has been permanently restricted by donors or limited by donors to a specific purpose, as well as trustee-held funds under bond indenture agreements and irrevocable trusts. Amounts required to meet current liabilities of the Corporation are reported in current assets in the consolidated statements of financial position.

(f) Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed over the estimated useful life of each class of depreciable asset using the straight-line method. Buildings and improvements lives range from 5 to 40 years and equipment from 3 to 20 years. Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(g) Deferred Financing Costs

Deferred financing costs, which relate to the issuance of long-term bonds payable to the Rhode Island Health and Educational Building Corporation (RIHEBC), are being amortized ratably over the periods the bonds are outstanding.

(h) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity.

(i) Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, net assets released from restrictions used for purchase of property and equipment, and the cumulative effect of change in accounting principle for conditional asset retirement obligations.

(j) Net Patient Service Revenue

The Corporation provides care to patients under Medicare, Medicaid, managed care and commercial insurance contractual arrangements. The Corporation has agreements with many third-party payors that provide for payments at amounts less than its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with some third-party payors.

Medicare utilizes a prospective payment system for most inpatient hospital services rendered to Medicare program beneficiaries based on the classification of each case into a diagnostic-related group (DRG). Medicare outpatient hospital services are also paid using an ambulatory payment classification system.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Most hospital services to Rhode Island Medicaid patients are reimbursed based on negotiated costs under a prospective cost arrangement. The tentative hospital reimbursement rates are determined by certain negotiated budgeted expenditures and budgeted volume. Variances from budgeted volume are reimbursable at rates which may differ from the budgeted rate.

The majority of payments from managed care and commercial insurance companies are based upon negotiated fixed pricing arrangements, whereby a combination of per diem rates and specific case rates are utilized for inpatient services, along with fixed fees applicable to outpatient services.

Settlements and adjustments arising under reimbursement arrangements with some third-party payors, primarily Medicare, Medicaid and Blue Cross, are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Corporation has classified a portion of accrued estimated third-party payor settlements as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year. Changes in the Medicare and Medicaid programs, such as the reduction of reimbursement, could have an adverse impact on the Hospital.

(k) *Provision for Bad Debts*

The Corporation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Additions to the allowance for doubtful accounts are made by means of the provision for bad debts. Accounts deemed uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

(l) *Charity Care*

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

(m) *Donor-Restricted Gifts*

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amounts received that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a donor restriction expires, that is, when a stipulated purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(n) Inventories

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost or market.

(o) Estimated Self-Insurance Costs

The Corporation participates in Lifespan self-insurance programs with other Lifespan affiliates for losses arising from medical malpractice claims, health benefits to its employees, and effective August 1, 2006, losses arising from workers' compensation claims. The Corporation has recorded provisions for estimated claims, which are based on Lifespan's own experience. The provisions for self-insured losses include estimates of the ultimate costs for both reported claims and claims incurred but not yet reported.

(p) Fair Value of Financial Instruments

The carrying amounts recorded in the consolidated statements of financial position for cash and cash equivalents, patient accounts receivable, assets limited as to use, accounts payable, intercorporate financing, accrued expenses, estimated third-party payor settlements, and estimated health care benefit self-insurance costs approximate their respective fair values. The estimated fair value of the Corporation's long-term debt is disclosed in note 11.

(q) Reclassifications

Certain 2005 amounts have been reclassified to conform with the 2006 reporting format.

(2) Cumulative Effect of Change in Accounting Principle

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations." Under FIN 47, costs related to legal obligations to perform certain activities in connection with the retirement, disposal or abandonment of assets are required to be accrued. The Corporation adopted the provisions of FIN 47 effective October 1, 2005.

The Corporation has identified asbestos abatement as a conditional asset retirement obligation. Asbestos abatement costs were estimated based on relevant facts and circumstances. At September 30, 2006, the Corporation recorded site improvements of \$15,974, related accumulated depreciation of \$13,312, asset retirement obligations of \$33,232 included in other accrued expenses, and a cumulative effect of change in accounting principle to October 1, 2005 of \$30,570.

(3) Disproportionate Share

The Hospital is a participant in the State of Rhode Island's Disproportionate Share Program, established in 1995 to assist hospitals which provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including the Hospital, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. Total payments to the Hospital under the Disproportionate Share Program aggregated \$4,238,027 and \$3,941,740 in 2006 and

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

2005, respectively, and are reflected as part of net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

The State of Rhode Island has assessed a license fee to all Rhode Island hospitals, based on each hospital's 2004 net patient service revenue as defined. The Hospital's license fee expense was \$2,975,999 and \$2,390,761 in 2006 and 2005, respectively. The hospitals in the State of Rhode Island accepted the fee as part of an agreement with the State's Department of Health and Human Services in return for an equitable distribution of funds to those hospitals meeting certain criteria in providing services to the Medicaid population.

For periods beyond 2006, the federal government could change the level of federal matching funds for the Disproportionate Share Program. Accordingly, it may be necessary for the State of Rhode Island to modify the program and the reimbursement to Rhode Island hospitals under the program. At this time, the scope of such modifications or their effect on the Hospital cannot be reasonably determined.

(4) Charity Care and Community Services

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies.

The following information measures the level of charity care provided by the Corporation during the years ended September 30:

	2006	2005
Charges forgone, based on established rates	\$ 3,627,244	\$ 3,118,040
Estimated costs and expenses incurred to provide charity care	\$ 1,794,035	\$ 1,451,759

Certain restricted funds have been designated by donors to fund charity care. Transfers totaling \$959,075 and \$563,198, respectively, have been made from these restricted funds in support of charity care in 2006 and 2005, and are reflected as net assets released from restrictions used for operations.

The Corporation also provides numerous other services to the community for which charges are not generated. These services include certain emergency services, community health screenings, child and adult health/medical education, participation in the Children's Access To Health program, immunization programs, patient advocacy, various support groups, foreign language translation and participation in various other community services and projects.

The Corporation subsidizes the cost of treating patients who receive government assistance where reimbursement is below cost.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Administrative uncompensated care, based on charges, amounted to \$689,080 and \$666,077 in 2006 and 2005, respectively. The related cost of such care approximated \$334,772 and \$304,090 in 2006 and 2005, respectively.

In addition to the cost of charity care and other community service programs, the Corporation provided \$5,782,439 and \$6,383,821 for uncollectible patient accounts, based on charges net of contractual allowances, during the years ended September 30, 2006 and 2005, respectively. The cost associated with such provisions approximated \$2,859,994 and \$2,972,307 in 2006 and 2005, respectively.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(5) Investments

Assets Limited as to Use

The composition of assets limited as to use at September 30, 2006 and 2005 is set forth in the following table.

	2006	2005
Internally board-designated:		
Cash and short-term investments	\$ 5,581,632	\$ 5,348,847
U.S. government and agency obligations	5,768,104	7,374,284
Corporate equity securities	48,019,468	46,574,425
Corporate obligations	10,382,588	10,220,499
Collective investment funds	80,032,447	65,204,196
Other investments	1,434,936	2,005,862
	<u>151,219,175</u>	<u>136,728,113</u>
Held by trustee under bond indenture agreement:		
U.S. government and agency obligations	<u>497,543</u>	<u>497,952</u>
Temporarily restricted funds:		
Cash and short-term investments	450,717	444,852
U.S. government and agency obligations	938,771	1,231,840
Corporate equity securities	7,815,271	7,780,045
Corporate obligations	1,689,788	1,707,288
Collective investment funds	13,025,451	10,892,062
Other investments	306,429	357,376
	<u>24,226,427</u>	<u>22,413,463</u>
Permanently restricted funds:		
Cash and short-term investments	3,891,983	3,720,854
U.S. government and agency obligations	1,660,007	2,247,657
Corporate equity securities	11,779,958	11,673,302
Corporate obligations	2,357,894	2,038,475
Collective investment funds	18,175,429	15,453,635
Other investments	433,681	240,235
	<u>38,298,952</u>	<u>35,374,158</u>
Total	<u>\$ 214,242,097</u>	<u>\$ 195,013,686</u>

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Investment income and gains for assets limited as to use are comprised of the following for the years ended September 30:

	<u>2006</u>	<u>2005</u>
Endowment earnings contributed toward community benefit	\$ 994,850	\$ 997,257
Nonoperating gains:		
Unrestricted income from board-designated investments	\$ 2,468,632	\$ 2,337,250
Net realized gains on sales of securities	10,780,962	8,938,013
	<u>\$ 13,249,594</u>	<u>\$ 11,275,263</u>
Other changes in unrestricted net assets:		
Net unrealized gains on investments	\$ 2,831,553	\$ 9,098,730
Changes in temporarily restricted net assets:		
Income from restricted investments	\$ 671,352	\$ 620,212
Net realized and unrealized gains on investments	2,432,572	3,216,441
	<u>\$ 3,103,924</u>	<u>\$ 3,836,653</u>
Changes in permanently restricted net assets:		
Income from and net realized gains on sales of investments	\$ 576,534	\$ 1,219,381

The following criteria are considered in determining other than temporary declines in the fair market value of individual investments:

- The unrealized loss must be present for at least a nine-month period, with a fair market value/cost ratio of less than 75% at both the beginning and end of the period.
- Investments with a fair market value/cost ratio of 25% or less are written down immediately.
- Investments for which the manager has increased the position by at least 20% in the last nine months are not adjusted unless the fair market value/cost ratio is 25% or less; otherwise, those investments are monitored for possible adjustment in future periods.
- Investments whose fair market value/cost ratio is below 75% at the beginning of a nine-month period, but above 65% at the end of said period are not adjusted but rather are monitored for possible adjustment in future periods.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Information regarding investments with unrealized losses at September 30, 2006 and 2005 is presented below, segregated between those that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months (dollars in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2006:						
Internally board-designated, temporarily restricted and permanently restricted funds:						
U.S government and agency obligations	\$ 3,471	\$ 17	\$ 3,675	\$ 120	\$ 7,146	\$ 137
Corporate obligations	2,046	30	2,945	120	4,991	150
Total debt securities	5,517	47	6,620	240	12,137	287
Corporate equity securities	5,532	781	2,603	405	8,135	1,186
Collective investment funds	10,829	698	856	80	11,685	778
Total temporarily impaired securities	\$ 21,878	\$ 1,526	\$ 10,079	\$ 725	\$ 31,957	\$ 2,251

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2005:						
Internally board-designated, temporarily restricted and permanently restricted funds:						
U.S government and agency obligations	\$ 12,730	\$ 232	\$ 1,016	\$ 39	\$ 13,746	\$ 271
Corporate obligations	6,298	147	1,038	33	7,336	180
Total debt securities	19,028	379	2,054	72	21,082	451
Corporate equity securities	8,192	837	2,617	580	10,809	1,417
Total temporarily impaired securities	\$ 27,220	\$ 1,216	\$ 4,671	\$ 652	\$ 31,891	\$ 1,868

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The following table sets forth changes in internally board-designated investments for the years ended September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Internally board-designated investments at beginning of year	\$ 136,728,113	\$ 118,737,570
Investment income:		
Dividend and interest income	2,468,632	2,337,250
Net realized gains on sales of securities	10,780,962	8,938,013
Net unrealized gains on investments	2,831,553	9,098,730
Withdrawals	<u>(1,590,085)</u>	<u>(2,383,450)</u>
Internally board-designated investments at end of year	<u>\$ 151,219,175</u>	<u>\$ 136,728,113</u>

Trustees' Accounts

Under the terms of the will of the late George N. Buckhout, the Trustees of the Hospital (Trustees) were appointed trustees of a fund established for the benefit of persons requiring financial aid for any type of medical or surgical care. Applications for assistance from the Buckhout fund are to be submitted to a committee of three physicians. Upon approval by this committee, disbursements are made from the fund. The investments of this fund, which are included in assets limited as to use and temporarily restricted net assets in the accompanying consolidated statements of financial position, amounted to \$4,773,993 and \$4,563,840 at September 30, 2006 and 2005, respectively.

Under the terms of the will of the late Harold W. Brooks, the Trustees were appointed trustees of a fund established to purchase or rent diagnostic or therapeutic equipment to be used at the Hospital. Applications for disbursements from the Brooks fund are to be submitted to a group of physicians for approval. Upon approval from the Brooks committee, disbursements are made from the fund. The investments of this fund, which are included in assets limited as to use and temporarily restricted net assets in the accompanying consolidated statements of financial position, amounted to \$12,578,708 and \$11,302,076 at September 30, 2006 and 2005, respectively.

The composition of the above two Trustees' accounts at September 30, 2006 and 2005 is set forth in the following table.

	<u>2006</u>	<u>2005</u>
U.S. government and agency obligations	\$ 686,151	\$ 887,340
Corporate equity securities	5,712,209	5,604,252
Corporate obligations	1,235,072	1,229,822
Collective investment funds	9,520,349	7,845,953
Other investments	<u>198,920</u>	<u>298,549</u>
	<u>\$ 17,352,701</u>	<u>\$ 15,865,916</u>

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Assets Held in Trust

The Hospital is the sole beneficiary of a trust held in perpetuity by Bank of America (formerly Fleet Bank). Under the terms of the will of the late Adelaide Roberts, the income from the trust is to be used to provide financial aid for persons requiring medical and nursing services. The trust's investments, which are included in assets limited as to use and permanently restricted net assets in the accompanying consolidated statements of financial position, totaled \$1,287,348 and \$1,224,800 at September 30, 2006 and 2005, respectively.

The composition of this trust at September 30, 2006 and 2005 is set forth in the following table.

	2006	2005
Corporate equity securities	\$ 874,700	\$ 799,029
U.S. government and agency obligations	350,066	356,281
Cash and short-term investments	62,582	69,490
	<u>\$ 1,287,348</u>	<u>\$ 1,224,800</u>

(6) Promises to Give

Included in contributions receivable are the following unconditional promises to give:

	2006	2005
Capital campaign	\$ 448,855	\$ 460,585
Restricted to future periods	710,923	621,449
Unconditional promises to give before unamortized discount and allowance for uncollectibles	1,159,778	1,082,034
Less unamortized discount at rate of 1.45% in both 2006 and 2005	(16,817)	(15,691)
Subtotal	1,142,961	1,066,343
Less allowance for uncollectibles	(65,042)	(150,015)
Net unconditional promises to give	<u>\$ 1,077,919</u>	<u>\$ 916,328</u>
Amounts due in:		
Less than one year	\$ 448,855	\$ 460,585
One to five years	707,523	610,939
More than five years	3,400	10,510
Total	<u>\$ 1,159,778</u>	<u>\$ 1,082,034</u>

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(7) Property and Equipment

Property and equipment, by major category, is as follows at September 30:

	2006	2005
Land and improvements	\$ 2,895,857	\$ 2,895,857
Buildings and improvements	92,181,394	89,540,223
Equipment	46,920,090	46,594,864
	<u>141,997,341</u>	<u>139,030,944</u>
Less accumulated depreciation and amortization	67,474,115	62,805,615
	<u>74,523,226</u>	<u>76,225,329</u>
Construction in progress	487,284	1,046,216
Property and equipment, net	<u>\$ 75,010,510</u>	<u>\$ 77,271,545</u>

Depreciation and amortization expense for the years ended September 30, 2006 and 2005 amounted to \$6,211,142 and \$6,176,083, respectively.

The estimated additional cost of completion of construction in progress approximated \$2,869,000 at September 30, 2006, comprised of building renovation projects.

(8) Pension and Other Postretirement Benefits (all dollars in thousands)

Pension Benefits

Effective December 31, 1997, the Pension Plan for Employees of Newport Health Care Corporation and Subsidiaries (the Newport Plan) merged into the Lifespan Corporation Retirement Plan (the Plan). Each employee who was a participant in the Newport Plan and was an eligible employee on December 31, 1997 continues to be a participant in the Plan on and after December 31, 1997, subject to the provisions of the Plan. Employees are included in the Plan on the first of the month which is the later of their first anniversary of employment and the attainment of age 18.

The Plan is intended to constitute a plan described in Section 414(k) of the Internal Revenue Code, under which benefits are derived from employer contributions based on the separate account balances of participants in addition to the defined benefits provided under the Plan, which are based on an employee's years of credited service and annual compensation. Lifespan's funding policy is to contribute amounts to the Plan sufficient to meet minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as may be determined to be appropriate by Lifespan.

Substantially all employees of Lifespan Corporation who meet the above requirements are eligible to participate in the Plan. Lifespan uses a measurement date of June 30 for the Plan.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Benefit Obligations

	<u>2006</u>	<u>2005</u>
Change in benefit obligation:		
Benefit obligation, beginning of year	\$ 363,010	\$ 303,766
Service cost	21,198	17,743
Interest cost	19,495	19,607
Benefits paid	(16,701)	(14,310)
Administrative expenses	(1,065)	(1,092)
Actuarial (gain) loss	(37,825)	37,296
Projected benefit obligation, end of year	\$ <u>348,112</u>	\$ <u>363,010</u>

The accumulated benefit obligation at the end of 2006 and 2005 was \$300,221 and \$306,904, respectively.

The following assumptions were used to determine end of year benefit obligations:

	<u>2006</u>	<u>2005</u>
Weighted average discount rate	6.25%	5.0%
Rate of increase in future compensation levels	4.5%	4.5%

Plan Assets

	<u>2006</u>	<u>2005</u>
Change in plan assets:		
Fair value of plan assets, beginning of year	\$ 265,119	\$ 241,427
Actual return on plan assets	32,251	22,857
Employer contributions	18,512	16,237
Administrative expenses	(1,065)	(1,092)
Benefits paid	(16,701)	(14,310)
Fair value of plan assets, end of year	\$ <u>298,116</u>	\$ <u>265,119</u>

Employer contributions and benefits paid in the above table include only those amounts contributed directly to or paid directly from Plan assets.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The asset allocation for the Plan at June 30, 2006 and 2005, and the target allocation for 2007, by asset category, are as follows:

Asset Category	Target Allocation 2007	Percentage of Plan Assets at June 30	
		2006	2005
U.S. equity	25-40%	23.4%	26.7%
Absolute return	0-15%	9.9%	7.9%
International equity	10-30%	26.1%	22.9%
Venture capital	0-10%	1.8%	1.8%
Commodities	0-10%	11.5%	10.1%
Real estate	0-15%	8.6%	8.0%
Fixed income	15-35%	18.7%	19.5%
Cash and cash equivalents	0-10%	—	3.1%
Total		100.0%	100.0%

The above table does not include \$56,033 and \$48,676 of Plan assets at June 30, 2006 and 2005, respectively, attributable to the separate savings account balances of participants which are managed in various mutual funds by Fidelity Investments.

The overall financial objective of the Plan is to meet present and future obligations to beneficiaries, while minimizing long-term contributions to the Plan (by earning an adequate return on Plan assets), with moderate volatility in year-to-year contribution levels.

The primary investment objective of the Plan is to provide a satisfactory return on investment in support of the above objective. The Plan's specific investment objective is to attain an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation by the Consumer Price Index.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Funded Status

The funded status of the Plan, reconciled to the amount reported on Lifespan's consolidated statements of financial position, follows:

	<u>2006</u>	<u>2005</u>
Fair value of plan assets	\$ 298,116	\$ 265,119
Benefit obligations	<u>348,112</u>	<u>363,010</u>
Funded status	(49,996)	(97,891)
Unrecognized net loss from past experience different from that assumed	8,733	62,506
Prior service cost not yet recognized in net periodic pension cost	<u>5,693</u>	<u>6,693</u>
Net pension liability recognized in Lifespan's consolidated statements of financial position	\$ <u>(35,570)</u>	\$ <u>(28,692)</u>
Net pension asset recognized in the Corporation's consolidated statements of financial position	\$ <u>4,503</u>	\$ <u>5,510</u>

The net pension asset recognized in the Corporation's consolidated statements of financial position at September 30, 2006 and 2005 consists of:

	<u>2006</u>	<u>2005</u>
Noncurrent asset (included in other noncurrent assets)	\$ 5,023	\$ 6,013
Current liability (included in accrued employee benefits and compensation)	<u>(520)</u>	<u>(503)</u>
Total	\$ <u>4,503</u>	\$ <u>5,510</u>

At the end of 2006 and 2005, the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets were as follows:

	<u>2006</u>	<u>2005</u>
Projected benefit obligation	\$ 348,112	\$ 363,010
Accumulated benefit obligation	300,221	306,904
Fair value of plan assets	298,116	265,119

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Expected Cash Flows

Information about the expected cash flows for the Plan follows:

Employer contributions:		
2007 (expected)	\$	24,990
Expected benefit payments:		
2007	\$	17,400
2008		18,300
2009		20,200
2010		20,700
2011		23,100
2012-2016		146,800

Management evaluates its Plan assumptions annually and the expected contribution in 2007 could increase.

Net Periodic Pension Cost

Components of net periodic pension cost are as follows for the years ended September 30:

	2006	2005
Service cost	\$ 21,198	\$ 17,743
Interest cost	19,495	19,607
Expected return on plan assets	(20,766)	(18,922)
Net amortization and deferral	5,463	3,103
Net periodic pension cost for Lifespan	\$ 25,390	\$ 21,531
Net periodic pension cost for the Corporation	\$ 1,653	\$ 1,299

The following assumptions were used to determine net periodic pension cost:

	2006	2005
Weighted average discount rate	5.0%	6.25%
Expected long-term rate of return on plan assets	8.0%	8.0%
Rate of increase in future compensation levels	4.5%	4.5%

Lifespan employs a rigorous process to annually determine the expected long-term rate of return on Plan assets which is only changed based on significant shifts in economic and financial market conditions. These estimates are primarily driven by actual historical asset-class returns along with our long-term outlook for a globally diversified portfolio. Asset allocations are regularly updated based on evaluations of future market returns for each asset class.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

New Accounting Pronouncement Re: Pension and Other Postretirement Benefit Plans

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." FASB Statement No. 158, which is an amendment of FASB Statements No. 87, 88, 106 and 132R, requires an employer to recognize in its statement of financial position an asset for a benefit plan's over funded status or a liability for a plan's underfunded status, with a corresponding increase or decrease in unrestricted net assets. The funded-status amount will be measured as the difference between the fair value of plan assets and the benefit obligation, including all actuarial gains and losses and prior service cost.

The requirement to recognize the funded status of Lifespan's benefit plans is effective as of September 30, 2007. Based on the Corporation's portion of the September 30, 2006 funded-status amounts for the Lifespan Corporation Retirement Plan, the Corporation would record an increase in unrestricted net assets of \$2,010 in 2007.

Other Postretirement Benefits

In addition to providing pension benefits, the Corporation provides a life insurance benefit for retired employees. Under Statement of Financial Accounting Standards No. 106, the cost of postretirement benefits other than pensions must be recognized on an accrual basis as employees perform services to earn the benefits. The Corporation provides the life insurance benefit to retirees and employees who were age 60 or older with at least 10 years of service as of October 1, 2004. The benefit liability is included in other liabilities in the accompanying consolidated statements of financial position, totaling \$545 and \$517 at September 30, 2006 and 2005, respectively.

(9) Patient Service Revenue and Related Reimbursement

A major portion of the Corporation's revenue is received from third-party payors. The following is an approximate percentage breakdown of gross patient service revenue by payor type for the years ended September 30:

	2006	2005
Medicare and Senior Care	41%	41%
Blue Cross	20%	21%
Medicaid and Rite Care	8%	8%
Managed care	11%	11%
Commercial, self-pay, and other	20%	19%
	100%	100%

The Corporation grants credit to patients, most of whom are local residents. The Corporation generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, managed care and commercial insurance policies).

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The Medicare 2006 cost report has not been filed, while the 2005 cost report has been filed, but not settled. The Medicaid 2004, 2005 and 2006 cost reports have not been filed.

Regulations in effect require annual settlements based upon cost reports filed by the Hospital. These settlements are estimated and recorded in the accompanying consolidated financial statements. Changes in these estimates are reflected in the consolidated financial statements in the year in which they occur. Net patient service revenue in the accompanying consolidated statements of operations and changes in net assets was increased by \$1,028,287 and \$1,568,986 in 2006 and 2005, respectively, to reflect changes in the estimated settlements for certain prior years.

Revenues from Medicare and Medicaid programs accounted for approximately 41% and 8%, respectively, of the Corporation's gross patient service revenue for the year ended September 30, 2006. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action; failure to comply with such laws and regulations can result in fines, penalties and exclusion from Medicare and Medicaid programs.

(10) Income Tax Status

NHCC and its affiliates are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from Federal income taxes pursuant to Section 501(a) of the Code.

(11) Long-Term Debt

Long-term debt consists of the following at September 30:

	2006	2005
Hospital Financing Revenue fixed rate serial and term bonds due July 1, 2007 through 2029 in annual amounts ranging from \$630,000 to \$1,890,000 at rates ranging from 4.5% to 5.3% (1999 Series – Newport Hospital)	\$ 26,235,000	\$ 26,840,000
Hospital Financing Revenue variable rate bonds (3.56% at September 30, 2006) due March 1, 2007 through 2014 in an annual amount of \$1,000,000 (2004 Series – Newport Hospital)	8,000,000	9,000,000
Total long-term debt	34,235,000	35,840,000
Less current portion	1,630,000	1,605,000
Long-term debt, excluding current portion	\$ 32,605,000	\$ 34,235,000

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The estimated fair value of the Corporation's long-term debt at September 30, 2006 amounts to \$35,008,000 and is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

On March 1, 2004, RIHEBC issued, on behalf of the Hospital, \$10,000,000 of tax-exempt bonds (the 2004 Bonds) to finance the renovation of medical/surgical inpatient beds, replace a CT Scan, purchase new beds and pay costs of issuance.

On February 1, 1999, RIHEBC issued, on behalf of the Hospital, \$30,000,000 of tax-exempt bonds (the 1999 Bonds) to finance the acquisition, construction, renovation and equipping of various Hospital facilities. The Bonds are secured by a pledge of the gross receipts of the Hospital.

Payment of the principal and interest on the 2004 and 1999 Bonds when due is guaranteed by Newport Hospital Foundation, Inc. Under the terms of the 2004 and 1999 Bonds, the Corporation is required to satisfy certain measures of financial performance as long as the bonds are outstanding. At September 30, 2006, the Corporation was in compliance with all covenants of the bonds.

The Corporation's aggregate maturities of long-term debt for the five fiscal years ending in September 2011 are as follows: 2007, \$1,630,000; 2008, \$1,660,000 and 2009, \$1,690,000; and 2010, \$1,720,000; and 2011, \$1,755,000.

Agreements underlying the 1999 Hospital Financing Revenue Bonds require that the Hospital maintain certain trustee-held funds, included with assets limited as to use in the consolidated statements of financial position, as follows:

Bond Fund – The Hospital is required to make quarterly deposits to the trustee sufficient to provide sinking funds for the payment of principal and interest to bondholders when due.

The balance of the 1999 Series Bond Fund at September 30, 2006 and 2005 is \$497,543 and \$497,952, respectively.

During the years ended September 30, 2006 and 2005, the Corporation's interest expense was \$1,676,103 and \$1,603,018, respectively. Interest paid was \$1,650,307 and \$1,599,470 during the years ended September 30, 2006 and 2005, respectively.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

A summary of interest cost and investment income on borrowed funds held by the trustee under the Corporation's bond indentures during the years ended September 30, 2006 and 2005, follows:

	2006	2005
Interest cost:		
Capitalized	\$ —	\$ 3,633
Charged to operations	1,676,103	1,603,018
Total	<u>\$ 1,676,103</u>	<u>\$ 1,606,651</u>
Investment income:		
Credited to other revenue	<u>\$ 16,853</u>	<u>\$ 12,307</u>

(12) Temporarily and Permanently Restricted Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	2006	2005
Capital and equipment	\$ 16,632,657	\$ 15,442,423
General health care service activities	10,075,710	9,667,940
Awards (employee recognition and education)	751,915	657,358
Total	<u>\$ 27,460,282</u>	<u>\$ 25,767,721</u>

Permanently restricted net assets at September 30 are restricted to:

	2006	2005
Investments to be held in perpetuity, the income from which is expendable for general health care service activities	\$ 25,909,873	\$ 24,922,089
Interest in perpetual trust (restricted to patient financial assistance)	1,287,348	1,224,800
Total	<u>\$ 27,197,221</u>	<u>\$ 26,146,889</u>

(13) Concentrations of Credit Risk

Financial instruments which potentially subject the Corporation to concentrations of credit risk consist primarily of accounts receivable and certain investments. The risk associated with temporary cash investments is mitigated by the fact that the investments are placed with what management believes are high credit quality financial institutions. Investments, which include government and agency obligations, stocks and corporate bonds, are not concentrated in any corporation or industry.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The Corporation receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Blue Cross, Medicaid and various managed care entities. The Corporation has not historically incurred any significant concentrated credit losses in the normal course of business.

(14) Malpractice and Other Litigation

Professional Liability/Medical Malpractice

Professional liability/medical malpractice coverage for the Hospital is supplied on a claims-made basis by Rhode Island Sound Enterprises Insurance Co., Ltd. (RISE), Lifespan's affiliated captive insurance company, which underwrites the medical malpractice risk of the Hospital. The adequacy of the coverage provided and the funding levels are reviewed annually by independent actuaries and consultants. The professional liability insurance provided by RISE has liability limits of \$4 million per medical incident with no annual aggregate. RISE provides a second layer of coverage, which has limits of an additional \$2 million per medical incident with a \$2 million annual aggregate. In addition, commercial umbrella excess insurance has been obtained by Lifespan to increase the total professional liability limits to \$22 million per claim.

The Hospital has been named as a defendant in a number of pending actions seeking damages for alleged medical malpractice. In the opinion of management, any liability and legal defense costs resulting from these actions will be within the limits of the Hospital's malpractice insurance coverage provided by RISE and/or commercial excess carriers.

General Liability

General liability coverage is provided to the Hospital by RISE amounting to \$4 million per incident and \$4 million in the annual aggregate. Commercial excess liability insurance has been obtained by Lifespan which provides aggregate general liability coverage of \$80 million.

Workers' Compensation

The Hospital has incurred a number of workers' compensation claims and, in the opinion of management, the liability of the Hospital will be within the limits of the assets of Lifespan's workers' compensation self-insurance trust fund.

Other Litigation

In addition to the actions discussed above, the Corporation is also involved in a number of miscellaneous suits and general liability suits arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results from operations.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(15) Related-Party Transactions

The Corporation was charged a management fee by Lifespan of \$9,941,952 and \$9,589,992 in 2006 and 2005, respectively, representing 10.6% of Lifespan's operating expenses in each year. Lifespan provides information services, human resources, financial, and various other support services to the Corporation.

In the normal course of business, the Corporation enters into transactions with Lifespan and other related entities. Included in intercorporate financing are the following amounts due (to) from related entities at September 30:

	2006	2005
Lifespan	\$ (263,241)	\$ (40,350)
Rhode Island Hospital	(185,099)	85,598
The Miriam Hospital	(157,364)	(90,307)
Emma Pendleton Bradley Hospital	1,130	—
Total intercorporate financing	\$ (604,574)	\$ (45,059)

(16) Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	2006	2005
Health care services	\$ 77,408,010	\$ 74,856,392
General and administrative:		
Depreciation and amortization	6,211,142	6,176,083
Interest	1,676,103	1,603,018
License fees	2,975,999	2,390,761
Other	15,881,500	15,777,649
Total general and administrative	26,744,744	25,947,511
	\$ 104,152,754	\$ 100,803,903



KPMG LLP
50 Kennedy Plaza
Providence, RI 02903-2321

**Independent Auditors' Report on
Supplementary Information**

The Board of Trustees
Newport Health Care Corporation:

We have audited and reported separately herein on the consolidated financial statements of Newport Health Care Corporation and Affiliates (the Corporation) as of and for the years ended September 30, 2006 and 2005.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements of the Corporation taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and changes in net assets (deficit), and cash flows of the individual entities. The consolidating information as of and for the years ended September 30, 2006 and 2005 has been subjected to auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

January 29, 2007

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES
Supplementary Consolidating Statement of Financial Position
September 30, 2006

	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated total
Assets								
Current assets:								
Cash and cash equivalents	\$ 7,521,681	\$ 366,378	\$ 228,602	\$ 12,982	\$ 920,473	\$ 9,050,116		\$ 9,050,116
Patient accounts receivable	12,786,259	—	—	—	307,762	13,094,021		13,094,021
Less allowance for doubtful accounts	(2,722,899)	—	—	—	(118,034)	(2,840,933)		(2,840,933)
Other receivables	10,063,360	—	—	—	189,728	10,253,088		10,253,088
Current portion of contributions receivable	—	18,736	—	276,963	75,809	371,508		371,508
Total receivables	—	18,736	—	276,963	75,809	448,855		448,855
Assets limited as to use	10,063,360	—	—	—	265,537	11,073,451		11,073,451
Inventories	5,604,860	—	—	—	—	5,604,860		5,604,860
Intercorporate financing	385,903	—	—	—	—	385,903		385,903
Prepaid expenses and other current assets	1,055,328	69,366	—	651,194	—	1,776,088		1,776,088
Total current assets	687,507	60,456	—	—	15,463	763,426		763,426
Interest in net assets of Newport Hospital Foundation	25,318,639	515,136	677,457	941,139	1,201,473	28,653,844		28,653,844
Assets limited as to use	129,759,284	—	—	—	—	129,759,284		129,759,284
Less amount required to meet current obligations	85,382,005	25,312	128,637,780	—	—	214,242,097		214,242,097
Noncurrent assets limited as to use	(5,604,860)	—	—	—	—	(5,604,860)		(5,604,860)
Property and equipment, net	79,977,145	22,312	128,637,780	—	—	208,637,237		208,637,237
Other assets:	70,794,143	4,142,411	—	—	73,956	75,010,510		75,010,510
Contributions receivable, net	—	—	629,064	—	—	629,064		629,064
Deferred charges and financing costs, net	313,684	—	1,000,000	—	—	313,684		313,684
Investments in consolidated affiliates	5,023,480	—	—	—	—	5,023,480		5,023,480
Other noncurrent assets	5,337,164	—	1,629,064	—	—	6,966,228		6,966,228
Total other assets	31,186,375	4,679,859	130,944,301	941,139	1,275,429	449,027,103		449,027,103
Total assets	\$ 311,186,375	\$ 4,679,859	\$ 130,944,301	\$ 941,139	\$ 1,275,429	\$ 449,027,103	\$ (132,537,872)	\$ 316,489,231
Liabilities and Net Assets (Deficit)								
Current liabilities:								
Accounts payable	\$ 1,896,515	\$ 52,304	—	—	\$ 17,859	\$ 1,966,878		\$ 1,966,878
Intercorporate financing	3,841,146	—	1,107,781	—	1,272,881	2,380,662		2,380,662
Accrued employee benefits and compensation	450,875	8,903	77,236	—	437,697	4,278,843		4,278,843
Current portion of long-term debt	1,630,000	—	—	—	12,699	549,713		549,713
Current portion of estimated third-party payor settlements	1,229,811	—	—	—	—	1,630,000		1,630,000
Estimated health care benefit self-insurance costs	374,809	—	—	—	—	1,229,811		1,229,811
Total current liabilities	9,423,156	61,407	1,185,017	—	25,669	400,478		400,478
Long term debt, net of current portion	32,605,000	—	—	—	1,766,805	12,436,385		12,436,385
Estimated third-party payor settlements, net of current portion	4,888,929	—	—	—	—	32,605,000		32,605,000
Other liabilities	544,600	—	—	—	—	4,888,929		4,888,929
Total liabilities	47,461,685	61,407	1,185,017	—	1,766,805	544,600		544,600
Net assets (deficit):								
Unrestricted	207,948,959	4,618,452	125,606,114	941,139	(491,376)	338,623,288		338,623,288
Temporarily restricted	28,578,510	—	4,153,170	—	—	32,731,680		32,731,680
Permanently restricted	27,197,221	—	—	—	—	27,197,221		27,197,221
Total net assets (deficit)	263,724,690	4,618,452	129,759,284	941,139	(491,376)	398,552,189		398,552,189
Total liabilities and net assets	\$ 311,186,375	\$ 4,679,859	\$ 130,944,301	\$ 941,139	\$ 1,275,429	\$ 449,027,103	\$ (132,537,872)	\$ 316,489,231

See accompanying independent auditors' report.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES
Supplementary Consolidating Statement of Financial Position
September 30, 2005

	Assets							
	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated Total
Current assets:								
Cash and cash equivalents	\$ 7,618,868	\$ 250,827	\$ 341,515	\$ 54,479	\$ 867,726	\$ 9,133,415	\$	\$ 9,133,415
Patient accounts receivable	11,836,101	—	—	—	344,404	12,200,507	—	12,200,507
Less allowance for doubtful accounts	(2,365,900)	—	—	—	(115,358)	(2,481,258)	—	(2,481,258)
Net patient accounts receivable	9,490,203	—	—	—	229,046	9,719,249	—	9,719,249
Other receivables	—	8,245	—	480,629	75,809	564,683	—	564,683
Current portion of contributions receivable	—	—	460,585	—	—	460,585	—	460,585
Total receivables	9,490,203	8,245	460,585	480,629	304,855	10,744,517	—	10,744,517
Assets limited as to use	5,377,462	—	—	—	—	5,377,462	—	5,377,462
Inventories	385,595	—	—	—	—	385,595	—	385,595
Interservice financing	940,532	505,234	—	441,501	—	1,887,367	\$ (1,887,367)	\$ —
Prepaid expenses and other current assets	795,785	47,861	—	—	38,272	881,918	(2,500)	879,418
Total current assets	24,608,445	812,167	802,100	976,709	1,210,853	28,410,274	(1,889,867)	26,520,407
Interest in net assets of Newport Hospital Foundation	117,707,225	—	—	—	—	117,707,225	(117,707,225)	—
Assets limited as to use	77,736,551	1,075,926	116,201,209	—	—	195,013,686	—	195,013,686
Less amount required to meet current obligations	(5,377,462)	—	—	—	—	(5,377,462)	—	(5,377,462)
Noncurrent assets limited as to use	72,359,089	1,075,926	116,201,209	—	—	189,636,224	—	189,636,224
Property and equipment, net	73,945,029	3,246,105	1,644	—	78,767	77,271,545	—	77,271,545
Other assets:								
Contributions receivable, net	—	—	455,743	—	—	455,743	—	455,743
Deferred charges and financing costs, net	329,399	—	—	—	—	329,399	—	329,399
Investments in consolidated affiliates	—	—	1,000,000	—	—	1,000,000	(1,000,000)	—
Other noncurrent assets	6,012,635	—	—	—	—	6,012,635	—	6,012,635
Total other assets	6,342,034	—	1,455,743	—	—	7,797,777	(1,000,000)	6,797,777
Total assets	\$ 294,961,822	\$ 5,134,198	\$ 118,460,696	\$ 976,709	\$ 1,289,620	\$ 420,823,045	\$ (120,597,092)	\$ 300,225,953
Liabilities and Net Assets (Deficit)								
Current liabilities:								
Accounts payable	\$ 1,569,439	\$ 279,328	\$ 763	\$ 546	\$ 15,213	\$ 1,865,289	\$	\$ 1,865,289
Interservice financing	—	—	668,584	—	1,263,842	1,932,426	(1,887,367)	45,059
Accrued employee benefits and compensation	3,526,371	—	—	—	448,627	3,974,998	—	3,974,998
Other accrued expenses	605,627	6,323	84,124	77,100	12,808	785,982	(2,500)	783,482
Current portion of long-term debt	1,605,000	—	—	—	—	1,605,000	—	1,605,000
Current portion of estimated third-party payor settlements	1,896,630	—	—	—	—	1,896,630	—	1,896,630
Estimated health care benefit self-insurance costs	518,184	—	—	—	55,414	573,598	—	573,598
Total current liabilities	9,721,251	285,651	753,471	77,646	1,795,904	12,633,923	(1,889,867)	10,744,056
Long term debt, net of current portion	34,235,000	—	—	—	—	34,235,000	—	34,235,000
Estimated third-party payor settlements, net of current portion	5,188,076	—	—	—	—	5,188,076	—	5,188,076
Other liabilities	517,300	—	—	—	—	517,300	—	517,300
Total liabilities	49,661,627	285,651	753,471	77,646	1,795,904	52,574,299	(1,889,867)	50,684,432
Net assets (deficit):								
Unrestricted	192,579,298	4,848,547	113,657,158	899,063	(506,284)	311,477,782	(113,850,871)	197,626,911
Temporarily restricted	26,574,008	—	4,050,067	—	—	30,624,075	(4,856,354)	25,767,721
Permanently restricted	26,146,889	—	—	—	—	26,146,889	—	26,146,889
Total net assets (deficit)	245,300,195	4,848,547	117,707,225	899,063	(506,284)	368,248,746	(118,707,225)	249,541,521
Total liabilities and net assets	\$ 294,961,822	\$ 5,134,198	\$ 118,460,696	\$ 976,709	\$ 1,289,620	\$ 420,823,045	\$ (120,597,092)	\$ 300,225,953

See accompanying independent auditor's report.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES
Supplementary Consolidating Statement of Operations and Changes in Net Assets (Deficit)
Year ended September 30, 2006

	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated Total
Unrestricted revenues and other support:								
Net patient service revenue	\$ 97,097,988			\$ 6,549	\$ 2,681,409	\$ 99,779,397		\$ 99,779,397
Other revenue	916,136	\$ 558,268			1,820,602	3,301,555	\$ (1,682,547)	1,619,008
Endowment earnings contributed toward community benefit	994,850					994,850		994,850
Net assets released from restrictions used for operations	959,075			210,192		1,169,267		1,169,267
Total unrestricted revenues and other support	99,968,049	558,268		216,741	4,502,011	105,245,069	(1,682,547)	103,562,522
Operating expenses:								
Compensation and benefits	53,309,219				4,175,391	57,484,610	(1,426,638)	56,058,492
Supplies and other expenses	15,874,331	306,200	\$ 4,035	209,896	575,001	16,969,463	(255,909)	16,713,554
Purchased services	14,469,977	210,448	6,869	6,869	40,862	14,735,025		14,735,025
Provision for bad debts	5,681,937		26,255		74,247	5,782,439		5,782,439
Depreciation and amortization	5,926,047	263,101	1,644		20,350	6,211,142		6,211,142
Interest	1,676,103					1,676,103		1,676,103
License fees	2,975,999					2,975,999		2,975,999
Total operating expenses	99,914,133	779,749	38,803	216,765	4,885,851	105,835,301	(1,682,547)	104,152,754
Income (loss) from operations	53,916	(221,481)	(38,803)	(24)	(383,840)	(590,232)		(590,232)
Nonoperating gains:								
Unrestricted income from board-designated investments	274,220	1,555	2,192,857			2,468,632		2,468,632
Net realized gains on sales of board-designated investments	143,502	317,181	10,320,279			10,780,962		10,780,962
Total nonoperating gains, net	417,722	318,736	12,513,136			13,249,594		13,249,594
Excess (deficiency) of revenues over expenses:	471,638	97,255	12,474,333	(24)	(383,840)	12,659,362		12,659,362
Other changes in unrestricted assets:								
Increase in interest in net assets of Newport Hospital Foundation	11,948,956					11,948,956	(11,948,956)	
Net unrealized gains (losses) on investments	2,931,491	(327,350)	227,412			2,831,553		2,831,553
Net assets released from restrictions used for purchase of equipment	21,154		(753,789)			21,154		21,154
Transfers (to) from affiliates				42,100	398,748	(311,941)	311,941	
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	(30,570)					(30,570)		(30,570)
Contributions of property and equipment	26,992					26,992		26,992
Increase (decrease) in unrestricted net assets	15,369,661	(230,095)	11,948,956	42,076	14,908	27,145,506	(11,637,015)	15,508,491
Temporarily restricted net assets:								
Gifts, grants and bequests	295,022		269,775			564,797	(311,941)	252,856
Income from restricted investments	647,832		23,520			671,352		671,352
Net assets released from restrictions	(980,229)		(210,192)			(1,190,421)		(1,190,421)
Net realized and unrealized gains on investments	2,432,572					2,432,572		2,432,572
Increase in interest in net assets of Newport Hospital Foundation	103,103					103,103	(103,103)	
Transfer to permanently restricted net assets	(473,798)					(473,798)		(473,798)
Transfers (to) from affiliates	(20,000)		20,000					
Increase in temporarily restricted net assets	2,004,502		103,103			2,107,605	(415,044)	1,692,561
Permanently restricted net assets:								
Net realized gains on investments held in perpetual trust by others	62,547					62,547		62,547
Realized gains retained to maintain purchasing power	513,987					513,987		513,987
Transfer from temporarily restricted net assets	(473,798)					(473,798)		(473,798)
Increase in permanently restricted net assets	1,050,332					1,050,332		1,050,332
Increase (decrease) in net assets	18,424,495	(230,095)	12,052,059	42,076	14,908	30,303,443	(12,052,059)	18,251,384
Net assets (deficit), beginning of year	245,300,195	4,848,547	117,707,225	899,063	(506,284)	368,248,746	(118,707,225)	249,541,521
Net assets (deficit), end of year	\$ 263,724,690	\$ 4,618,452	\$ 129,759,284	\$ 941,139	\$ (491,376)	\$ 398,552,189	\$ (130,759,284)	\$ 267,792,905

See accompanying independent auditors' report.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Supplementary Consolidating Statement of Operations and Changes in Net Assets (Deficit)
Year ended September 30, 2005

	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated Total
Unrestricted revenues and other support:								
Net patient service revenue	\$ 95,172,655					\$ 97,777,908		\$ 97,777,908
Other revenue	1,237,543	\$ 543,516		\$ 5,171	2,605,233	3,642,916	\$ (1,648,134)	1,994,782
Endowment earnings contributed toward community benefit	997,237				1,836,686	997,237		997,237
Net assets released from restrictions used for operations	563,198			223,303		786,501		786,501
Total unrestricted revenues and other support	\$ 97,970,633	\$ 543,516		\$ 228,474	\$ 4,461,939	\$ 103,204,582	\$ (1,648,134)	\$ 101,556,448
Operating expenses:								
Compensation and benefits	\$1,072,222				4,110,058	\$5,182,280	(1,373,737)	\$3,808,553
Supplies and other expenses	15,024,291	283,674	\$ 1,593	226,472	585,166	16,131,196	(274,407)	15,856,789
Purchased services	14,310,164	206,502	34,002	7,098	37,112	14,594,878		14,594,878
Provision for bad debts	6,274,146				109,873	6,383,821		6,383,821
Depreciation and amortization	5,925,814	226,241	5,186		18,842	6,176,083		6,176,083
Interest	1,603,018					1,603,018		1,603,018
License fees	2,390,761					2,390,761		2,390,761
Total operating expenses	\$6,600,416	716,417	40,781	333,570	4,860,853	\$102,452,037	(1,648,134)	\$100,803,903
Income (loss) from operations	\$1,370,237	(172,901)	(40,781)	(5,096)	(398,914)	752,545		752,545
Nonoperating gains:								
Unrestricted income from board-designated investments	165,240	28,647	2,143,363			2,337,250		2,337,250
Net realized gains on sales of board-designated investments	117,381	106,142	8,714,490			8,938,013		8,938,013
Unrestricted gifts and bequests	188,668					188,668		188,668
Total nonoperating gains, net	\$471,289	\$134,789	\$10,857,853			\$11,463,931		\$11,463,931
Excess (deficiency) of revenues over expenses	\$1,841,526	(38,112)	10,817,072	(5,096)	(398,914)	\$12,216,476		\$12,216,476
Other changes in unrestricted assets:								
Increase in interest in net assets of Newport Hospital Foundation	14,662,310					14,662,310	(14,662,310)	
Net unrealized gains on investments	3,509,249	81,091	5,508,390			9,098,730		9,098,730
Net assets released from restrictions used for purchase of equipment	18,147					18,147		18,147
Transfers from (to) affiliates	1,340,000		(1,663,152)	(26,100)	73,236	(276,016)	276,016	
Increase (decrease) in unrestricted net assets	21,371,232	42,979	14,662,310	(31,196)	(325,678)	35,719,647	(14,386,294)	21,333,353
Temporarily restricted net assets:								
Gifts, grants and bequests	179,739		208,434			388,173	(276,016)	112,157
Income from restricted investments	611,044		9,168			620,212		620,212
Net assets released from restrictions	(581,345)		(223,303)			(804,648)		(804,648)
Net realized and unrealized gains on investments	3,216,441					3,216,441		3,216,441
Decrease in interest in net assets of Newport Hospital Foundation	(5,701)					(5,701)	5,701	
Increase (decrease) in temporarily restricted net assets	3,420,178		(5,701)			3,414,477	(270,315)	3,144,162
Permanently restricted net assets:								
Net realized gains on investments held in perpetual trust by others	103,653					103,653		103,653
Realized gains retained to maintain purchasing power	1,115,728					1,115,728		1,115,728
Increase in permanently restricted net assets	1,219,381					1,219,381		1,219,381
Increase (decrease) in net assets	26,010,791	42,979	14,656,609	(31,196)	(325,678)	40,353,505	(14,656,609)	25,696,896
Net assets (deficit), beginning of year	219,289,404	4,805,568	103,050,616	930,259	(180,606)	327,895,241	(104,050,616)	223,844,625
Net assets (deficit), end of year	\$ 245,300,195	\$ 4,848,547	\$ 117,707,225	\$ 899,063	\$ (506,284)	\$ 368,248,746	\$ (118,707,225)	\$ 249,541,521

See accompanying independent auditors' report.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES
Supplementary Consolidating Statement of Cash Flows
Year ended September 30, 2006

	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated total
Cash flows from operating activities:								
Increase (decrease) in net assets	\$ 18,424,495	\$ (230,095)	\$ 12,052,059	\$ 42,076	\$ 14,908	\$ 30,303,443	\$ (12,052,059)	\$ 18,251,384
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:								
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	30,570	—	—	—	—	30,570	—	30,570
Net realized and unrealized (gains) losses on investments	(6,084,099)	10,169	(10,547,691)	—	—	(16,621,621)	—	(16,621,621)
Undistributed portion of change in interest in net assets of Newport Hospital Foundation	(12,052,059)	—	—	(42,100)	(398,748)	(12,052,059)	12,052,059	—
Transfers to (from) affiliates	—	—	752,789	—	—	752,789	(311,941)	—
Temporarily restricted gifts, grants, and bequests	(295,022)	—	(269,775)	—	—	(564,797)	311,941	(252,856)
Depreciation and amortization	5,926,047	263,101	1,644	—	20,350	6,211,142	—	6,211,142
Provision for estimated health care benefit self-insurance costs	6,004,951	—	—	—	388,553	6,393,504	—	6,393,504
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(6,148,326)	—	—	—	(418,298)	(6,566,624)	—	(6,566,624)
(Increase) decrease in patient accounts receivable, net	(573,157)	—	—	—	39,318	(533,839)	—	(533,839)
Increase in contributions receivable, net	—	—	(161,591)	—	—	(161,591)	—	(161,591)
Increase (decrease) in accounts payable	327,076	(226,824)	(763)	(546)	2,646	101,589	—	101,589
Increase (decrease) in accrued employee benefits and compensation	314,775	—	—	—	(10,930)	303,845	—	303,845
(Decrease) increase in other accrued expenses	(183,322)	2,580	(6,888)	—	(109)	(189,739)	—	(189,739)
Decrease in estimated third-party payor settlements	(965,966)	—	—	—	—	(965,966)	—	(965,966)
Decrease (increase) in all other current and noncurrent assets and liabilities, net	912,742	(23,086)	—	126,566	22,809	1,039,031	—	1,039,031
Net cash provided by (used in) operating activities	5,636,705	(204,135)	1,819,784	125,996	(339,501)	7,038,829	—	7,038,829
Cash flows from investing activities:								
Purchase of property and equipment	(2,775,161)	(1,159,407)	—	—	(15,539)	(3,950,107)	—	(3,950,107)
Other net (increases) decreases in assets limited to use	(1,533,957)	1,043,445	(1,888,880)	—	—	(2,379,392)	—	(2,379,392)
Net cash used in investing activities	(4,309,118)	(115,962)	(1,888,880)	—	(15,539)	(6,329,499)	—	(6,329,499)
Cash flows from financing activities:								
(Payments to) financing from affiliates	(114,796)	435,668	439,197	(209,593)	9,039	559,515	—	559,515
Payments on long-term debt	(1,605,000)	—	—	—	—	(1,605,000)	—	(1,605,000)
Transfers (to) from affiliates	—	—	(752,789)	42,100	398,748	(311,941)	311,941	—
Temporarily restricted gifts, grants and bequests	295,022	—	269,775	—	—	564,797	(311,941)	252,856
Net cash (used in) provided by financing activities	(1,424,774)	435,668	(43,817)	(167,493)	407,787	(792,629)	—	(792,629)
Net (decrease) increase in cash and equivalents	(97,187)	115,551	(112,913)	(41,497)	52,747	(83,299)	—	(83,299)
Cash and cash equivalents, beginning of year	7,618,868	250,827	341,515	54,479	867,726	9,133,415	—	9,133,415
Cash and cash equivalents, end of year	\$ 7,521,681	\$ 366,378	\$ 228,602	\$ 12,982	\$ 920,473	\$ 9,050,116	\$ —	\$ 9,050,116
Supplemental disclosure of cash flow information:								
Cash paid for interest	\$ 1,650,307	—	—	—	—	\$ 1,650,307	—	\$ 1,650,307

See accompanying independent auditors' report.

NEWPORT HEALTH CARE CORPORATION AND AFFILIATES

Supplementary Consolidating Statement of Cash Flows

Year ended September 30, 2005

	Newport Hospital	Newport Health Property Management	Newport Hospital Foundation	Newport Health Care Corporation	NHCC Medical Associates	Total	Eliminations	Consolidated total
Cash flows from operating activities:								
Increase (decrease) in net assets	\$ 26,010,791	\$ 42,979	\$ 14,656,609	\$ (31,196)	\$ (325,678)	\$ 40,353,505	\$ (14,656,609)	\$ 25,696,896
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:								
Net realized and unrealized gains on investments	(8,062,452)	(187,233)	(14,222,880)	—	—	(22,472,565)	—	(22,472,565)
Undistributed portion of change in interest in net assets of Newport Hospital Foundation	(14,656,609)	—	—	—	—	(14,656,609)	14,656,609	—
Transfers (from) to affiliates	(1,340,000)	—	1,663,152	26,100	(73,236)	276,016	(276,016)	—
Temporarily restricted gifts, grants, and bequests	(179,739)	—	(208,434)	—	—	(388,173)	276,016	(112,157)
Depreciation and amortization	5,925,814	226,241	5,186	—	18,842	6,176,083	—	6,176,083
Provision for estimated health care benefit self-insurance costs	4,425,872	—	—	—	258,937	4,684,809	—	4,684,809
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(3,907,688)	—	—	—	(203,523)	(4,111,211)	—	(4,111,211)
Decrease in patient accounts receivable, net	1,269,376	—	—	—	19,585	1,288,961	—	1,288,961
Decrease in contributions receivable, net	—	—	273,672	—	—	273,672	—	273,672
(Decrease) increase in accounts payable	(916,664)	277,640	763	546	(14,902)	(652,617)	—	(652,617)
(Decrease) increase in accrued employee benefits and compensation	(43,784)	—	—	—	15,296	(28,488)	—	(28,488)
Increase (decrease) in other accrued expenses	207,699	(13,066)	(1,938)	—	(1,590)	191,105	—	191,105
Decrease in estimated third-party payor settlements	(602,667)	—	—	—	—	(602,667)	—	(602,667)
Decrease in all other current and noncurrent assets and liabilities, net	337,015	251	—	303,766	239,871	880,903	—	880,903
Net cash provided by (used in) operating activities	8,466,964	346,812	2,166,130	299,216	(66,398)	11,212,724	—	11,212,724
Cash flows from investing activities:								
Purchase of property and equipment	(3,139,184)	(880,691)	—	—	(15,353)	(4,035,228)	—	(4,035,228)
Other net (increases) decreases in assets limited to use	(1,756,563)	771,353	(852,767)	—	—	(1,837,977)	—	(1,837,977)
Net cash used in investing activities	(4,895,747)	(109,338)	(852,767)	—	(15,353)	(5,873,205)	—	(5,873,205)
Cash flows from financing activities:								
(Payments to) financing from affiliates	(1,544,143)	(48,287)	257,202	(222,757)	641,417	(916,568)	—	(916,568)
Payments on long-term debt	(1,580,000)	—	—	—	—	(1,580,000)	—	(1,580,000)
Transfers from (to) affiliates	1,340,000	—	(1,663,152)	(26,100)	73,236	(276,016)	276,016	—
Temporarily restricted gifts, grants and bequests	179,739	—	208,434	—	—	388,173	(276,016)	112,157
Net cash (used in) provided by financing activities	(1,604,404)	(48,287)	(1,197,516)	(248,857)	714,653	(2,384,411)	—	(2,384,411)
Net increase in cash and equivalents	1,966,813	189,187	115,847	50,359	632,902	2,955,108	—	2,955,108
Cash and cash equivalents, beginning of year	5,652,055	61,640	225,668	4,120	234,824	6,178,307	—	6,178,307
Cash and cash equivalents, end of year	\$ 7,618,868	\$ 250,827	\$ 341,515	\$ 54,479	\$ 867,726	\$ 9,133,415	\$ —	\$ 9,133,415
Supplemental disclosure of cash flow information:								
Cash paid for interest	\$ 1,599,470					\$ 1,599,470		\$ 1,599,470

See accompanying independent auditors' report.